



U.S. COMMODITY FUTURES TRADING COMMISSION

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August 7, 2003

William J. Brodsky
Chairman
CBOE Futures Exchange, LLC
400 South LaSalle Street
Chicago, IL 60605

Re: Application of CBOE Futures Exchange, LLC for Designation as a Contract Market

Dear Mr. Brodsky:

By submissions dated July 19, 2002 through, July 31, 2003, CBOE Futures Exchange, LLC ("CFE" or "Exchange") has applied to the Commodity Futures Trading Commission ("Commission"), pursuant to Sections 5 and 6(a) of the Commodity Exchange Act ("Act"), 7 U.S.C. §§7 and 8(a), for designation as a contract market. The Commission has reviewed the materials submitted and has determined to designate CFE as a contract market, pursuant to Sections 5 and 6(a) of the Act, 7 U.S.C. §§7 and 8(a).

Concurrent with designation, the Commission approved, pursuant to Section 5c(c) of the Act, 7 U.S.C. §7a-2(c), CFE Rules: 101-163, 201-214, 301-310, 401-418, 501-515, 601-615, 701-714, 801-802, 901, 1001-1002, and 1101-1105; and Policies and Procedures I-V.

The Commission's approval is based upon, among other things, written submissions, explanations and representations provided by the Exchange describing the manner in which CFE will operate. The Commission's approval is also based upon written submissions, explanations, demonstrations, and representations provided by CFE and The Options Clearing Corporation ("OCC"), a derivatives clearing organization, concerning how OCC shall assist CFE in meeting the Exchange's clearing and self-regulatory obligations.

In approving CFE's application, the Commission is not approving the agreement for clearing services between CFE and OCC. In this connection, CFE and OCC each remain responsible for ensuring the performance of all self-regulatory functions required, as a designated contract market and a derivatives clearing organization respectively, under the Act and the Commission's regulations.

The Commission reminds the Exchange that the following items are considered "rules" under Part 40 of the Commission's regulations and that, accordingly, changes thereto should be submitted to the Commission pursuant to 5c(c) of the Act and Part 40 of the Commission's

Mr. William J. Brodsky
August 7, 2003
Page 2

regulations: (1) the exchange trading system; (2) the Policies and Procedures; (3) both the identity of and self-regulatory services provided to the exchange by third-party providers; (4) the trading algorithm (including the base allocation method and any priority overlays); (5) the market maker program; (6) the minimum contract size thresholds and reporting times for block trades; and (7) the minimum response period and any eligible size required prior to crossing trades or the designated waiting period required after pre-execution discussions.

In addition, the Commission reminds the Exchange that position limits or position accountability procedures must be specified for futures contracts listed by the Exchange where necessary and appropriate. Any such position limits or position accountability procedures should be submitted to the Commission in connection with the listing of each futures contract submitted under the Commission's certification or approval procedures. Finally, the Commission reminds the Exchange that, due to its incorporation of Chicago Board Options Exchange, Incorporated ("CBOE") rules by reference, changes to CBOE rules so incorporated should be submitted by the Exchange pursuant to section 5c(c) of the Act and Part 40 of the Commission's regulations.

Sincerely,

Catherine D. Dixon
Assistant Secretary of the Commission

cc: Kenneth Raisler, Sullivan & Cromwell
Frank Ochsenfeld, Sullivan & Cromwell

DCM Designation Form

July 31, 2003

To: The Commission

From: The Division of Market Oversight
The Office of the General Counsel
The Division of Enforcement
The Division of Clearing and Intermediary Oversight

Subject: Application of CBOE Futures Exchange, LLC (“CFE”) for Designation as a Contract Market pursuant to Sections 5 and 6(a) of the Commodity Exchange Act.

Recommendation: Staff recommends that the Commission designate CFE as a contract market and simultaneously approve CFE’s proposed rules.

Responsible Staff: Riva Spear Adriance x5494

Processing Information:

Official Receipt Date:	7/19/02
Fast-track Clock Terminated:	9/15/02
180-Day Review Period Stayed:	12/2/02
180-Day Review Period Restarted:	06/09/03
End of Statutory Review Period:	8/07/03

I. Background of the Applicant.

By submissions dated July 18, 2002, through July 31, 2003, the CBOE Futures Exchange, LLC (“CFE” or “Exchange”), a Delaware limited liability company whose sole member (“Owner”) is the Chicago Board Options Exchange, Incorporated (“CBOE”), applied to the Commodity Futures Trading Commission (“Commission” or “CFTC”) for designation as a contract market for the automated trading of futures contracts. The Exchange anticipates that it would offer trading of futures contracts on: futures and options on futures on broad-based security indexes in the near future, and possibly futures on narrow-based security indices at some later date.

CFE has contracted with The Options Clearing Corporation (“OCC”), a registered derivatives clearing organization, to carry out clearing and settlement services for all futures transactions under agreement with CFE. CFE staff will carry out all other exchange self-regulatory duties, including conducting trade practice, financial and market surveillance and investigations, and dispute resolution services. CFE will use the CBOE match engine, known as *CBOEdirect*, as the platform for the electronic trading facility.¹

The Commission has not previously approved CFE as a contract market. Accordingly, the Exchange has submitted to the Commission a proposed trade-matching algorithm, procedures and rules pertaining to CFE governance, disciplinary and arbitration procedures, trading standards, recordkeeping requirements, and various other materials to meet the requirements for a board of trade seeking designation as a contract market. In furtherance of its SRO responsibilities for contracts traded on the CFE trading system, the Exchange also has submitted proposed rules that would establish OCC as the entity for clearing contracts. CFE has provided the Commission with clear and sufficient information describing the services that OCC has committed to provide to CFE.

As set forth in Section II and III of this memorandum, the CFE application demonstrates compliance with the Commodity Exchange Act’s (“Act”) Section 5(b) Designation Criteria, Section 5(d) Core Principles, and Section 5c(b) Common Provisions regarding designation of contract markets and Part 38 of the Commission’s regulations. Accordingly, staff recommends that the Commission designate CFE as a contract market and simultaneously approve the following CFE Rules and Policies and Procedures: CFE Rules: 101-163, 201-14, 301-10, 401-

¹ CBOE, a national stock exchange for the trading of standardized, listed stock options, was founded in 1973. *CBOEdirect*, CBOE’s electronic trading matching system, began operation in October of 2001.

18, 501-15, 601-15, 701-14, 801-02, 901, 1001-02, and 1101-05; and Policies and Procedures I-V.

II. Analysis of CFE’s Contract Market Application, Outsourcing Agreement with OCC, and Proposed Rules for Compliance with the Act’s Designation Criteria for Designation as a Contract Market

CONTRACT MARKET CRITERIA FOR DESIGNATION	CFE PROPOSAL	COMMENTS
<p>Sec. 5(a) Applications – “A board of trade applying to the Commission for designation as a contract market shall submit an application to the Commission that includes any relevant materials and records the Commission may require consistent with this Act.”</p>		<p>Acceptable</p> <p>See Attachments</p>
<p>Sec. 5(b) CRITERIA FOR DESIGNATION</p>		
<p>Designation Criterion 1 <i>In General</i> – “To be designated as a contract market, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this subsection.”</p>		<p>Acceptable</p> <p>See Attachments</p>
<p>Designation Criterion 2 <i>Prevention of Market Manipulation</i> – “The board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 1; CFE Appendix B-1 (Rulebook) Rule 603 prohibits market manipulation; CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures); CFE Appendix D-1 Attachment 1 (Regulatory Services Division Summary of Regulatory Functions); and CFE Appendix D-3 (Department of Market Regulation: Surveillance Manual).</p>	<p>Acceptable.</p> <p>CFE will perform market surveillance through its Department of Market Regulation, which is one of four departments within CFE’s Regulatory Services Division consisting mostly of joint employees of both CFE’s and CBOE’s Regulatory Services Divisions. CFE will conduct all of its market surveillance (both real-time and post-trade). CFE has established procedures designed to reveal the commission of various trading abuses (including attempts to manipulate futures prices), and to monitor positions of large traders, deliverable supplies and futures and cash prices. CFE will have access to the Securities Industry Automation Corporation (“SIAC”), which will consolidate large trader information from all SROs.</p>
<p>Designation Criterion 3 <i>Fair and Equitable Trading</i> – “The board of trade shall establish and</p>	<p>CFE Appendix A-1 at 1 and CFE Appendix B-1 (Rulebook) Rules: 406 through</p>	<p>Acceptable.</p>

<p>enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and [sic] the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize – (A) transfer trades or office trades; (B) an exchange of futures – (i) futures in connection with a cash commodity transaction; (ii) futures for cash commodities; or (iii) futures for swaps; or (C) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded or cleared in accordance with the rules of the contract market or a derivatives clearing organization”</p>	<p>408 (Execution of Orders by CBOE System, Crossing Trades, Market Data/Execution Acknowledgements), 414 (EFP), 415 (Block Trading), 416 (Error Trades), 514 (Market Maker Programs), 601 (Fraudulent Acts), 602 (Fictitious Transactions), 610 (Priority of Customers’ Orders), 611 (Trading Against Customers’ Orders), 612 (Disclosing Orders), 613 (Pre-Arranged Trades), and 614 (Simultaneous Buying and Selling Orders).</p>	<p>CFE will conduct trade practice surveillance and investigate possible trading abuses through its Department of Market Regulation, which is one of four departments within CFE’s Regulatory Services Division consisting mostly of joint employees of both CFE’s and CBOE’s Regulatory Services Divisions. CFE has established procedures for detection and investigation of trading abuses. CFE has represented that the trade practice and market surveillance that it conducts would be comparable to or consistent with the description of such surveillance set forth in Appendix D-3 and consistent with the demonstration of those services provided to Commission staff on June 26, 2003.</p> <p>Information regarding all transacted prices would be provided to users with real-time access to data. A “snapshot” summary of market depth would be provided to all users on a real-time basis upon request, with the first five levels of the book depth dynamically updated. Trading Privilege Holders (persons with CFE trading privileges), including their “Authorized Traders” (associated persons) and related parties, would have access to the trading system.</p>
<p>Designation Criterion 4 Trade Execution Facility – “The board of trade shall (A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 2; CFE Appendix B-1 (Rulebook) Rules: 403–11 (Entry and Execution of Orders) and 514-15 (Market Maker Programs); CFE Appendix C-1 (CBOE<i>direct</i> Functional Requirements); Appendix A-3 (CFE Responses dated October 3, 2002) at 2; and Appendix A-4 (CFE Responses dated November 8, 2002) at 1-2.</p> <p>CFE’s Contract Market Application; CFE Appendix C-1 (System Description). CBOE’s response to CFTC’s Technical Review questionnaire (in the course of contract market designation applications for both OneChicago, LLC (OCX) and CFE);</p>	<p>Acceptable.</p> <p>CFE will use the CBOE match engine, known as CBOE<i>direct</i>, as the platform for the electronic trading facility.</p> <p>CBOE<i>direct</i> will support both price-time priority (i.e., first in/first out at each price level) and combined price-time and size priority (pro rata) for futures (orders at identical prices would be filled in proportion to their size sequentially by entry time). The CBOE<i>direct</i> system allows the Exchange to select certain priorities that would overlay the pro-rata allocation. The applicable base allocation method and, if applicable, priority overlay (including whether a trade participation right will be granted to market makers (“DPMs”)) would be determined on a contract-</p>

	<p>CBOE API Volume 7: CBOE<i>direct</i> Certification and Testing Procedures; CBOE FIX Protocol Support Volume 6: FIX 4.2 Certification and Testing Guide; Architecture View Visio Diagram; CBOE<i>direct</i> Deployment Version 2.0.0 Visio Diagram; Change Password Procedures; Screen Based Trading Application Architecture; CBOE Audit Reports with updated Management Responses for CFTC of 1/16/02; SBT Version 1.0 Test Specification; System Capacity and Performance; SBT Failover Mechanism and Tests; Systems Support Organization Chart; Help Desk Organization Chart; and Help Desk User Guide Version 1.1.</p>	<p>by-contract basis. According to CFE, no decision has been made which base allocation methods or priority overlays should apply to particular products.</p> <p>CBOE has provided, including as part of the OCX designation review, extensive documentation regarding the development, operation, and maintenance of their electronic trade execution facility. That documentation includes system architecture diagrams and descriptions, security features and procedures, system development life cycle procedures and management, testing procedures, capacity planning practices, failover recovery plans, and help desk procedures. CBOE also provided a series of audit reports performed by CBOE’s Internal Audit and reviewed by Deloitte & Touche LLP. These documents also include updated management responses for the CFTC.</p> <p>A site visit was made to the CBOE data center as part of the designation review for OCX. OCX uses the same trading engine and data center facilities that will support futures trading at the CBOE. Documentation received specific to the CBOE application did not indicate any substantial change warranting another site visit. During the visit to the CBOE operations and system development areas on behalf of the OCX, the system and its supporting infrastructure, the testing of the system, the staff and operational control facilities supporting the operation, and the physical security and environmental controls provided by the CBOE facilities were reviewed and found to be acceptable.</p> <p>All technical and operational information obtained by staff supports a conclusion that CBOE’s proposed electronic trading system would comply with the IOSCO principles for screen-based trading.</p>
<p>Designation Criterion 5 <i>Financial Integrity of Transactions</i> – “The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market,</p>	<p>CFE Appendix B-1 (Rulebook) Rules: 119 (Clearing Member), 304 (Eligibility of Trading Privileges), 503 (Minimum Financial and Related Reporting Requirements for Registrants), 505 (Treatment of Customer Funds and Securities), 506 (Additional</p>	<p>Acceptable.</p> <p>CFE has entered into a clearing agreement with OCC, a registered DCO.</p>

<p>including the clearance and settlement of the transactions with a derivatives clearing organization.”</p>	<p>Minimum Financial Requirements), 1101 (Clearing Member Guarantee), 1102 (Responsibility of Trading Privilege Holders); and CFE Appendix E-1 (Clearing and Settlement Service Agreement between OCC and CFE).</p>	<p>CFE Rule 503 provides that each Clearing Member, and Trading Privilege Holder that is registered with the Commission as a Futures Commission Merchant (“FCM”) or Introducing Broker (“IB”) must comply with the minimum financial requirements for FCMs and IBs set forth in Commission Rule 1.17 (if in the future CFE lists security futures products for trading, those that are registered with the SEC would be required to comply with the minimum financial requirements for BDs set forth in SEC Rule 15c3-1). Rule 1.17 (as well as Rule 15c3-1) provides that a dually-registered FCM/BD must maintain minimum adjusted net capital at a level that is equal to or greater than the Commission’s minimum adjusted net capital requirement or the SEC’s minimum adjusted net capital requirement. CFE Rule 506 provides that CFE may impose capital requirements on Clearing Members that would exceed CFTC (or SEC) minimums.</p> <p>Each transaction must be entered by, or guaranteed by, a Clearing Member of OCC. Accordingly, OCC’s financial and reporting obligations apply to each of the Clearing Members that clear trades executed on CFE. OCC Rule 301 requires a Clearing Member to maintain a minimum adjusted net capital of \$1,000,000. OCC also monitors the financial condition of its members by requiring such members to file monthly financial statements (Rule 306). Clearing Members are also required, under OCC’s “Early Warning System,” to provide notice to OCC no later than 3:00 pm on the following business day, (a) of any financial difficulty affecting the Clearing Member or any failure of the Clearing Member to be in compliance with financial responsibility or net capital rules of any regulatory organization, (b) if its net capital falls below \$1,000,000, or (c) upon the occurrence of other material adverse changes in the Clearing Member’s financial condition or organizational structure. In addition, each Clearing Member is subject to OCC’s risk management programs (OCC Rule 303).</p> <p>Clearing Members will also be subject to periodic</p>
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		<p>examination by their respective designated self-regulatory organization (“DSRO”) or designated examining authority (“DEA”). Clearing Members that are registered futures commission merchants will continue to be subject to routine examination by a DSRO pursuant to the Joint Audit Committee (“JAC”) Audit Plan. Clearing Members that are registered brokers or dealers will be subject to routine examination on the securities side by a DEA.</p> <p>In addition, CFE intends to apply to become a member of the JAC upon its designation as a contract market. If CFE grants Trading Privileges to an entity that does not have a DSRO, CFE will undertake the financial auditing of such entity. CBOE staff will perform the surveillance for the CFE staff. CFE’s review of FOCUS reports will include the additional schedules required to be filed by FCMs and the 1-FRs for member FCMs that are not BDs who are assigned to CFE pursuant to the JAC plan. This review of additional financial schedules should pose no issues for CFE or CBOE staff.</p>
<p>Designation Criterion 6 Disciplinary Procedures – “The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 3; CFE Appendix B-1 (Rulebook) Rules: Chapter 7 (Discipline and Enforcement), 207 (Business Conduct Committee), 307 (Limitations of Trading Privileges), and 308 (Application of Rules and Jurisdiction); CBOE Rule 2.1(a) (Establishment of Committees) (incorporated by reference); CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures); and CFE Appendix D-3 (Investigator’s Manual for the Department of Market Regulation).</p>	<p>Acceptable. CFE disciplinary procedures are consistent with Commission regulations and interpretive guidance regarding core principles.</p> <p>CFE’s Department of Market Regulation is one of four departments within CFE’s Regulatory Services Division consisting mostly of joint employees of both CFE’s and CBOE’s Regulatory Services Divisions. CFE’s Office of Enforcement, which is an office within CFE’s Legal Division, consists mostly of joint employees of both CFE’s and CBOE’s Legal Divisions.</p> <p>The Department of Market Regulation would investigate possible rule violations and present written investigation reports to the CFE Business Conduct Committee, which would authorize and issue a notice of charges to commence a disciplinary proceeding. The CBOE Business Conduct Committee would carry out the duties of the CFE Business Conduct</p>

		Committee. Any panel of the committee that heard the charges would include three individuals. The Department of Market Regulation would fill the prosecutorial function in these proceedings.
Designation Criterion 7 <i>Public Access</i> – “The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.”	CFE Appendix A-1 (Application Memorandum) at 3 and CFE Appendix B-1 (Rulebook) Rule 310.	Acceptable. CFE represents that it would post all rules and contract specifications on its website, and disseminate changes to rules and contract specifications by mail, fax or e-mail to each trading privilege holder, as well as publish such notices on the CFE website.
Designation Criterion 8 <i>Ability to Obtain Information</i> – “The board of trade shall establish and enforce rules that will allow the board of trade to obtain any necessary information to perform any of the functions described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.”	CFE Appendix A-1 (Application Memorandum) at 3; CFE Appendix B-1 (Rulebook) Rules: 214 (Regulatory Cooperation), 501 (Books and Records), 502 (Inspection and Delivery), 702 (Complaint and Investigation); and CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures).	Acceptable. Clearing members and Trading Privilege Holders would be required to make their books and records available for inspection by, and deliver copies thereof as requested by, CFE. The Division of Market Regulation would have the authority to inspect and request books and records and to request testimony regarding any possible violation of the Rules of the Exchange. CFE represents that it would join the Intermarket Surveillance Group (“ISG”) and Intermarket Financial Surveillance Group (“IFSG”) and become a party to other relevant information-sharing agreements to assure that it has access to market surveillance data and other information relevant to its self-regulatory programs.

III. Analysis of CFE’s Contract Market Application, CFE’s Outsourcing Agreements with OCC, and Proposed Rules for Compliance with the Act’s Core Principles for Designation as a Contract Market.

CONTRACT MARKET CORE PRINCIPLES	CFE PROPOSAL	COMMENTS
<p>Sec. 5c(b) Common Provisions Applicable to Registered Entities (1) In General – “A contract market or derivatives transaction execution facility may comply with any applicable core principle through delegation of any relevant function to a registered futures association or another registered entity.” (2) Responsibility – “A contract market or derivatives transaction execution facility that delegates a function under paragraph (1) shall remain responsible for carrying out the function.”</p>		<p>Acceptable</p> <p>CFE would remain responsible for compliance with designation criterion and core principles for which relevant functions would be contracted out.</p>
<p>SEC. 5c(e) NEW CONTRACTS, NEW RULES, AND RULE AMENDMENTS – (1) In General – Subject to paragraph (2), a registered entity may elect to list for trading or accept for clearing any new contract or other instrument, or may elect to approve and implement any new rule or rule amendment, by providing to the Commission (and the Secretary of the Treasury, in case of a contract for sale of a government security for future delivery (or an option on such a contract) or a rule or rule amendment specifically related to such a contract) a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act). (2) Prior Approval – (A) In General – A registered entity may request that the Commission grant prior approval to any new contract or other instrument, new rule, or rule amendment.</p>		<p>Acceptable</p> <p>CFE has requested that the Commission approve its proposed rules (including the proposed Rulebook and Policies and Procedures), in connection with its designation as a contract market. The Divisions recommend such approval pursuant to Section 5c(c)(2)(A) of the Act, since the Policies and Procedures and Rulebook do not violate any provision of the Act or the Commission's regulations.</p>

<p>Core Principle 1 <i>In General</i> – “To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles.”</p>		<p>Acceptable</p>
<p>Core Principle 2 <i>Compliance with Rules</i> – “The board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.”</p>	<p>CFE Appendix B-1 (Rulebook) Rules 701-14 (Discipline and Enforcement) CFE Appendix C-1 (System Description) CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures)</p>	<p>Acceptable.</p> <p>CFE will conduct trade practice surveillance and investigate possible trading abuses through its Department of Market Regulation, which is one of four departments within CFE's Regulatory Services Division. The staff of CBOE's Regulatory Services Division that currently performs surveillance and regulatory functions for the CBOE will become joint employees of both CBOE and CFE, although at least one will be an employee solely of CFE.</p> <p>CFE has established procedures for detection and investigation of trading abuses. <i>See supra</i> discussion under Designation Criterion 3. CFE has established appropriate procedures to promote the fairness of investigations and ensure appropriate, thorough and timely investigative analysis. CFE would have sufficient staff and electronic resources for conducting investigations and has established procedures for regular report and document review to detect possible trading abuses.</p> <p>CFE would maintain a full electronic audit trail record of all trades, orders, quotes and other entries to the trading system. Details of all entries into the trading system, including date and time of such entries and the user ID of the user making the entry, are captured and loaded into an electronic transaction history database. The electronic transaction history database is stored for seven years. CFE regulatory systems can retrieve information from the electronic transaction history database as needed throughout the seven-year period.</p>

<p>Core Principle 3 <i>Contracts Not Readily Subject to Manipulation</i> – “The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.”</p>	<p>CFE Application at 3-4.</p>	<p>Acceptable.</p> <p>CFE did not submit a futures or option contract with its contract market application. CFE intends to submit contract terms and conditions after it has been approved as a contract market.</p>
<p>Core Principle 4 <i>Monitoring of Trading</i> – “The board of trade shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.”</p>	<p>CFE Application at 4; CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures); CFE Appendix D-1, Attachment 1 (Regulatory Services Division Summary of Regulatory Functions) at 1; and CFE Appendix D-3 (Department of Market Regulation: Surveillance Manual).</p>	<p>Acceptable.</p> <p>CFE surveillance staff will consist of staff from CBOE’s Regulatory Services Division who will be jointly employed by CFE and CBOE. CFE’s application states that the Exchange will implement practices and procedures to monitor trading to prevent manipulation, price distortion and disruptions of the delivery or cash-settlement process. CFE will obtain large trader information from its parent company CBOE through its existing agreement with the SIAC. The surveillance procedures outlined in Appendix D-1 Attachments 1 and 3 should minimize the potential for manipulation or the distortion of prices.</p>
<p>Core Principle 5 <i>Position Limitations or Accountability</i> – “To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 4; CFE Appendix B-1 (Rulebook) Rules 412 and 1001; CFE Appendix D-1, (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures); CFE Appendix D-1, Attachment 1 (Regulatory Services Division Summary of Regulatory Functions); and CFE Appendix D-3 (Department of Market Regulation: Surveillance Manual).</p>	<p>Acceptable.</p> <p>Position limits or accountability limits would be established in rules and contract specifications of CFE futures and options contracts. Those contracts are not included in the CFE contract market application. The CFE application acknowledges CFTC Regulation 41.25 on the setting of position limits, exemptions from position limits for bona fide hedging positions.</p> <p>The Commission should remind the Exchange that position limits or position accountability procedures must be specified for contracts listed by the Exchange where necessary and appropriate. All position limits or position accountability procedures should be included with the Exchange’s filing to the Commission in connection with the listing of a futures contract submitted under the Commission’s certification or approval procedures.</p>

<p>Core Principle 6 Emergency Authority – “The board of trade shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, where necessary and appropriate, including the authority to – “(A) liquidate or transfer open positions in any contract; (B) suspend or curtail trading in any contract; and (C) require market participants in any contract to meet special margin requirements.”</p>	<p>CFE Application at 4; CFE Appendix B-1 (Rulebook) Rules: 132 (Definition of Emergency), 213 (Conflicts of Interest), and 417 (Emergencies).</p>	<p>Acceptable</p> <p>The Chief Executive (or a designee approved by the Board) could place into immediate effect temporary rules. Among other actions, the Chief Executive could order the liquidation of contracts, the fixing of the settlement price or liquidation-only trading, suspend or limit trading, extend/shorten the expiration date or month, extend the time of delivery or change delivery points and/or the means of delivery, modify trading hours, impose position or price limits, or modify or suspend the rules of the Exchange of the Clearing Corporation. <i>See infra</i> Core Principle 15 (Conflicts of Interest) for further discussion regarding conflicts of interest in decision-making.</p> <p>The Chief Executive Officer (or his designee approved by the Board) could also take various actions in response to physical emergencies, which would include any circumstance that could have a severe or adverse effect upon physical functions</p>
<p>Core Principle 7 Availability of General Information – “The board of trade shall make available to market authorities, market participants, and the public information concerning – (A) the terms and conditions of the contracts of the contract market; and (B) the mechanisms for executing transactions on or through the facilities of the contract market.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 3; CFE Appendix B-1 (Rulebook) Rules: 310 (Notices), 403 (Order Entry), 404 (Acceptable Orders), 406 (Execution of Orders by CBOE System), and 503-506 (Financial Requirements).</p>	<p>Acceptable.</p> <p>CFE will publish its rules, regulations and contract specifications on its website.</p>
<p>Core Principle 8 Daily Publication of Trading Information – “The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 5.</p>	<p>Acceptable.</p> <p>Daily information on settlement prices, volume and open interest will be made public through CFE’s website and market data vendors.</p>
<p>Core Principle 9 Execution of Transactions – “The board of trade shall provide a competitive, open, and efficient market and mechanism for executing</p>	<p>CFE Appendix A-1 (application Memorandum) at 5; CFE Appendix B-1 (Rulebook) Rule: 415 (Block Trading) and 403 – 407 (Entry and Execution of</p>	<p>Acceptable.</p> <p>Block trade minimum size and reporting time would be</p>

<p>transactions.”</p>	<p>Orders); CFE Appendix B-2 (Policies and Procedures)</p> <p>CFE Appendix C-1 (System Description). CBOE’s response to CFTC’s Technical Review questionnaire (in the course of contract market designation applications for both OCX and CFE); CBOE API Volume 7: CBOE<i>direct</i> Certification and Testing Procedures; CBOE FIX Protocol Support Volume 6: FIX 4.2 Certification and Testing Guide; Architecture View Visio Diagram; CBOE<i>direct</i> Deployment Version 2.0.0 Visio Diagram; Change Password Procedures; Screen Based Trading Application Architecture; CBOE Audit Reports with updated Management Responses for CFTC of 1/16/02; SBT Version 1.0 Test Specification; System Capacity and Performance; SBT Failover Mechanism and Tests; Systems Support Organization Chart; Help Desk Organization Chart; and Help Desk User Guide Version 1.1</p>	<p>set on a product-specific basis and, accordingly, would be submitted to the Commission with the contract terms and conditions for specific products.</p> <p>CBOE has provided sufficient documentation and other information for Commission staff to conclude that the CBOE system would comply with the IOSCO principles for screen-based trading systems.</p> <p>The CBOE<i>direct</i> system is currently in use for CBOE screen-based options trading and for OCX futures trading, so it is of proven production quality. Sufficient tests have been run demonstrating required capacity for futures could be met. Also, because of the modular system architecture design, adding additional capacity should be relatively easy.</p> <p>The applicant’s system development process shows a high level of maturity as evidenced by their use of sound systems and software engineering practices such as requirements documentation, system design modeling, written test plans, automated testing, automated support for configuration management, and multiple levels of quality assurance reviews.</p> <p>Periodic independent audits of the system have been and will continue to be conducted. Previous recommendations for improvements have been acted upon.</p> <p>The data center is of production quality and the operations staff is experienced managing equipment supporting high volume trading. Essentially all of the key application and data servers have redundant back-up equipment in stand-by mode.</p> <p>Building security is tight with the use of a metal detector, multiple guards, and mandatory checking of personal belongings prior to entry. Access to the data center, development labs, etc. is via access cards. Various system security measures are in place including encryption, digital signatures, passwords, and</p>
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		<p>intrusion detection software. CBOE<i>direct</i> is on a private network on which the remote workstations have a digital certificate and are reauthorized every 2 minutes.</p>
<p>Core Principle 10 Trade Information – “The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 5; CFE Appendix B-1 (Rulebook) Rule 403 (Order Entry); CFE Appendix B-2 (Policies and Procedures); CFE Appendix C-1 (System Description).</p>	<p>Acceptable.</p> <p>CFE will conduct trade practice surveillance and investigate possible trading abuses through its Department of Market Regulation, which is one of four departments within CFE's Regulatory Services Division. CFE has established procedures for detection and investigation of trading abuses. CFE has established procedures for detection and investigation of trading abuses.</p> <p>Orders submitted to CFE for non-market makers must specify buy or sell, price, quantity, time in force, session, contingency (if applicable), account type/CTI/origin code, branch sequence number (if applicable) executing firm, broker acronym, correspondent firm ID (if applicable), CMTA clearing member ID (if applicable) and customer account number (sub-account ID). Orders that do not contain the required information will be rejected.</p> <p>Orders entered by market makers must specify order type (product and month, buy or sell, price, quantity, contingency), account designation (executing firm, broker acronym), time in force and account type (origin).</p> <p>Prior to entering any order, the relevant Trading Privilege Holder (including its Authorized Traders and Related Parties) shall sign onto the CBOE system by inputting the user identification assigned for such purpose by the Exchange. The user identification, consisting of a user acronym and an Exchange identifier would be carried from the point of order or quote entry through the submission of executed trades to clearing and would be available as part of the audit trail. CFE Rules make Trading Privilege Holders</p>

		<p>responsible for every order entered into the system by them, their Authorized Traders and Related Parties.</p> <p>All orders not entered into the trading system immediately upon receipt by a Trading Privilege Holder, Authorized Trader or Related Party must be recorded in non-alterable written medium on an order form that is timestamped with the receipt of the order.</p> <p>The trading system would automatically capture all details of each trade in a comprehensive electronic audit trail. Every action in respect to an order or quote would be timestamped to a millisecond. A complete record of all order and quote activities would be provided to the CBOE electronic transaction history database. The electronic transaction history tables would be updated each time an order is changed, with the date and time of such change, as well as the user ID of the user making the change. Order history would be retained and retrievable for seven years. CFE would also maintain a history of all quote requests for a period of seven years. All activity within the trading system would be recorded in the data warehouse in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss.</p> <p>The CBOE<i>direct</i> database will be replicated on a near real-time basis by the CBOE data warehouse that CBOE will use to store, retrieve and manage the regulatory data. The data warehouse replicates every transaction that occurs in the CBOE<i>direct</i> system. During such replication, all details of orders and quotes and RFQs will be captured and loaded into a database, where they will be stored for seven years.</p> <p>The CBOE's computer surveillance systems would enable CFE to reconstruct cleared market transactions on a T+1 basis and to sort all transaction history data as desired.</p>
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<p>Core Principle 11 <i>Financial Integrity of Contracts</i> – “The board of trade shall establish and enforce rules providing for the financial integrity of any contracts traded on the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization), and rules to ensure the financial integrity of any futures commission merchants and introducing brokers and the protection of customer funds.</p>	<p>CFE Appendix A-1 (Application Memorandum) at 2 and 7; CFE Appendix B-1 (Rulebook) Rules: 103 (Applicable Law), 119 (Clearing Member), 304 (Eligibility of Trading Privileges), 503 (Minimum Financial and Related Reporting Requirements for Registrants), 505 (Treatment of Customer Funds and Securities), 506 (Additional Minimum Financial Requirements), 1101 (Clearing Member Guarantee), 1102 (Responsibility of Trading Privilege Holders); and CFE Appendix E-1 (Clearing and Settlement Service Agreement between OCC and CFE).</p>	<p>Acceptable</p> <p>CFE Rules 302 and 507 provide that an entity soliciting or accepting an order from any other person must be registered with the Commission (or, if CFE lists security futures products, registered with the SEC) in a capacity that permits it to solicit or accept orders from other persons. Therefore, any entity transacting customer orders on CFE must be registered as an FCM with the Commission (or, if CFE lists security futures products, as a BD with the SEC).</p> <p>CFE Rule 304 authorizes CFE to deny trading privileges for, among other reasons, the same reasons for which the NFA may deny or revoke registration of a person as an FCM or if such person is unable to satisfactorily demonstrate a capacity to adhere to all applicable rules.</p> <p>CFE Rules 103, 503 and 505 provide that each Trading Privilege Holder and Clearing Member comply with relevant sections of the Act and CFTC regulations regarding minimum financial, reporting, recordkeeping requirements, as well as the provisions relating to the maintenance of books and records, and the treatment of customer funds. A violation of any CFTC regulation or Act provision constitutes a violation of CFE rules.</p> <p>CFE has entered into a clearing agreement with OCC, a registered DCO. All transactions executed on CFE must be entered into or guaranteed by a Clearing Member (and all Clearing Members are members of OCC). CFE Rules 304 and 1101 require each Trading Privilege Holder that is not itself a Clearing Member to obtain prior authorization from a Clearing Member who will guarantee such transactions or enter into an appropriate arrangement with a person that has such authorization from a Clearing Member. A Clearing Member shall be liable for all trades made by such Trading Privilege Holder.</p> <p>OCC Rule 301 requires clearing members to have at</p>
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		least \$1,000,000 of initial minimum capital and to maintain \$750,000 of minimum capital on an ongoing basis.
<p>Core Principle 12 <i>Protection of Market Participants</i> – “The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 5; CFE Appendix B-1 (Rulebook) Rules: 403 (Order Entry), 415 (Block Trading), 508 (Confirmations), 511 (Fraudulent or Misleading Communications), 512 (Responsibility for Customer Orders), 601-15 (Business Conduct), and 701-14 (Discipline and Enforcement); CFE Appendix B-2 (Policies and Procedures); CFE Appendix D-1 (Description of Market Surveillance, Compliance and Enforcement Practices and Procedures); and CFE Appendix D-3 (Investigators’ Manual for the Department of Market Regulation).</p>	<p>Acceptable.</p> <p>CFE has established systems and procedures for detection and investigation of trading abuses. <i>See</i> additional discussion under Designation Criterion 3, above. CFE will use these systems to monitor for, among other things, position limit violations, trading ahead, wash sales, marking the close, non-competitive trades, and money laundering. The CFE will also conduct position accountability reviews (to identify accounts that maintain a sizable position in any one expiration month), review trader profiles (to detect aberrations from a trader’s normal pattern of trading), and perform profit/loss analyses.</p> <p>Trading Privilege Holders handling customer orders are required to exercise due diligence in the handling and execution of such orders. Except as specifically described in the CFE’s rules, wash trades and pre-arranged trades are prohibited. Fraudulent acts and manipulations are prohibited, as is conduct inconsistent with just and equitable principles of trade.</p>
<p>Core Principle 13 <i>Dispute Resolution</i> – “The board of trade shall establish and enforce rules regarding [sic] and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 6; CFE Appendix B-1 (Rulebook) Rules 801-02 (Arbitration); and CBOE Rules Chapter XVIII (incorporated by reference).</p>	<p>Acceptable.</p> <p>Arbitration will be carried out in accordance with Chapter XVIII of CBOE’s rules. Any dispute, claim or controversy arising between customers and Trading Privilege Holders, between Trading Privilege Holders (including related parties), and between Trading Privilege Holders and any other person are eligible for arbitration at the request of a party and upon approval of the Director of Arbitration (provided that a customer shall not be subject to arbitration without the customer’s prior written consent in accordance with Commission Regulation 166.5(c)).</p>

<p>Core Principle 14 <i>Governance Fitness Standards</i> – “The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this paragraph).”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 6; CFE Appendix B-1 (Rulebook) Rule 204 (Eligibility); CFE Appendix F-3 (Governance Fitness Information); and CFE Responses to Commission questions dated June 25, 2002 and August 8, 2002.</p>	<p>Acceptable.</p> <p>CFE Rule 204 incorporates fitness standards contained in Commission Regulation § 1.63. CFE will determine the fitness of each prospective member of its Board, Executive Committee, Business Conduct Committee, and other relevant bodies defined in Regulation § 1.63, by referring to the databases maintained by NASD and NFA.</p> <p>CFE’s General Counsel, after appropriate due diligence, must certify each relevant individual’s absence of any history of disciplinary offenses. The General Counsel has made that determination for the three initial directors of CFE. Appendix F-3.</p> <p>Persons subject to fitness standards must notify CFE of any change in status. In addition, the above-described fitness determination will be repeated on an annual basis for each member of the Board and relevant committees.</p>
<p>Core Principle 15 <i>Conflicts of Interest</i> – “The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision-making process of the contract market and establish a process for resolving such conflicts of interest.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 6; CFE Appendix B-1 (Rulebook) Rules: 201 (Management by the Board), 212 (Confidentiality) and 213 (Conflicts of Interest); CFE Appendix F-1 (Certificate of Formation); and CFE Responses to questions dated October 29, 2002, June 27, 2003 and July 21, 2003.</p>	<p>Acceptable.</p> <p>CFE Rule 213(b) prohibits any governance or disciplinary official from deliberating or voting in any matter involving a person with whom the official has a family, employment or business relationship.</p> <p>In addition, such an official may not deliberate or vote on “significant” exchange actions in which the official knows of a financial interest. CFE requires members to disclose any such conflicts of interests. The rule also sets forth a detailed inquiry to be undertaken by the General Counsel to assure objectively that non-abstaining members of a voting body are not subject to a prohibited financial interest. A member may participate in the deliberation of a matter in which the member has a substantial financial interest if the members decided that such participation was consistent with the public interest, and necessary for a quorum or</p>

		<p>the member possesses unique expertise. Any decisions made pursuant to this above deliberation exemption, and the rationales for those decisions, would be recorded in the minutes for the meeting in question.</p> <p>If CFE's three-member board of directors cannot, because of director conflicts, marshal either a quorum or a voting majority on any issue, then CBOE, as the sole member of CFE, decides the matter. CBOE's designee in such a case would be subject to CBOE's policy prohibiting conflicts of interest.</p> <p>CFE Rule 212 limits the use or disclosure of material non-public information gained through the performance of official duties.</p>
<p>Core Principle 16 <i>Composition of Boards of Mutually Owned Contract Markets</i> – “In the case of a mutually owned contract market, the board of trade shall ensure that the composition of the governing board reflects market participants.”</p>		<p>Not-Applicable. CFE would not be a mutually-owned exchange, as membership would not represent an ownership interest in the Exchange. Instead, the Exchange is owned by CBOE.</p>
<p>Core Principle 17 <i>Recordkeeping</i> – “The board of trade shall maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of 5 years.”</p>	<p>CFE Appendix A-1 (Application Memorandum) at 7; CFE Appendix B-1 (Rulebook) Rules: 403 (Order Entry) and 502 (Inspection and Delivery); and CFE Appendix C-1 (CBOE<i>direct</i> Functional Requirements) at 21-26.</p>	<p>Acceptable. CFE will conduct its trade practice surveillance and investigate possible trading abuses.</p> <p>CFE has represented that it would comply with Commission Regulation 1.31 and that a duplicate set of data would be kept off-site by the CBOE<i>direct</i> system.</p> <p>The CBOE<i>direct</i> system would automatically capture details of each trade in a comprehensive electronic audit trail record of all trades, orders, quotes and other entries to the trading system. Details of all entries into the trading system, including date and time of such entries, the user ID of the user making the entry, and the time of execution to the nearest millisecond are captured and loaded into an unalterable order history database. The order history database is stored for seven years. CFE regulatory systems can retrieve information from the order history database as needed throughout the seven-year period.</p>

<p>Core Principle 18 Antitrust Considerations – “Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid – “(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any material anticompetitive burden on trading on the contract market.”</p>	<p>CFE Appendix A-1 (Application), at 6; CFE Appendix B-1 (Rulebook). Rules: 304(b) (Eligibility for Trading Privileges), 406 (Execution of Orders), 415 (Block Trading), 513 (System Security), and 514 (Market Maker Programs); and CFE Response to questions dated October 29, 2002).</p>	<p>Acceptable. See <i>also infra</i> the Section IV.A for discussion of CFE’s parent company’s participation in the OCX joint venture agreement.</p> <p>CFE will be available to a potentially unlimited number of participants, on similar terms of access. CFE will operate through predetermined electronic algorithms, without discrimination among different users or user groups. Trade information will be disseminated to market participants and the public on a continuous basis.</p> <p>The Commission should remind the Exchange that the Commission is not approving service agreements for compliance with Core Principle 18.</p>
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IV. Novel or Unusual Issues

A. Antitrust Considerations - Parent Company's Participation in a Joint Venture Agreement

1. Summary.

During review of the application, a question arose as to whether a covenant by joint venture participants, including the parent corporation of CFE, not to compete with each other in single stock futures products for three years raised a concern regarding the applicant's compliance with Core Principle 18 and the Commission's obligations under section 15(b) of the Act.² Staff considered the question and concluded that the joint venture presents no Core Principle 18 concerns that would preclude the Commission from approving the application.

Staff's conclusion is based on the fact that the joint venture in which CFE's parent is a participant is not an activity attributable to CFE itself. Thus, any issues arising from the existence or operation of the joint venture agreement are not appropriate for consideration in the context of an application by CFE. In addition, staff concluded that the parent's participation in the joint venture would have no foreseeable adverse impact, either direct or indirect, on CFE's ability to operate as a stand-alone futures exchange.

2. Analysis

CFE is a wholly-owned subsidiary of the CBOE, which is a prominent market for exchange-traded equity options. The parent company, CBOE, undertook earlier involvement in futures trading in May 2001, when it, along with the Chicago Mercantile Exchange ("CME") and the Chicago Board of Trade ("CBOT"), entered into a joint venture to establish and operate an electronic market, OCX to trade security futures products. The joint venture agreement contains

² Section 15(b) obligates the Commission to endeavor to take the "least anticompetitive means" to achieve the objectives, policies and purposes of the Act in, among other things, approving any contract market "bylaw, rule or

a covenant by the joint venture participants not to compete with each other in single stock futures products for three years.³ Given the corporate relationship between CBOE and CFE, staff considered the joint venture agreement's likely impact on CFE as part of its Core Principle 18 review.

Core Principle 18 states: "Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid—(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any anticompetitive burden on trading on the contract market."⁴

After deliberation, staff concluded, as stated above, that the covenant not to compete contained in the joint venture agreement does not appear to impede CFE from complying with Core Principle 18. Staff determined that issues regarding the joint venture agreement should be considered separately from its review of the CFE application. In reviewing an applicant's compliance with the core principles, staff must determine whether the conduct or proposed

regulation." The Commission applies the same general analysis in fulfilling its obligations under Section 15(b) and under Core Principle 18.

³ As relevant here, the joint venture agreement provided:

For the period commencing on the date of execution of [the] Agreement and ending on the earlier of (1) the third anniversary of the first day of trading of Security Futures Products by [OCX] or (2) May 31, 2005, no Owner or Affiliate of any Owner will, either directly or indirectly, as an owner, shareholder, member, joint venturer, director, officer, agent, employee or consultant, solely or jointly with others, promote, market or engage in any business or enterprise that is engaged or seeks to engage in the business of trading, marketing, regulating, selling, purchasing, clearing or settling transactions in Security Futures Products; provided, however, that this restriction shall not apply to Security Futures Products that are based upon any 'narrow based security index' as such term is defined in the [Commodity Futures Modernization Act].

Operating Agreement of [OCX], executed on August 28, 2001, (OCX Joint Venture Agreement) at 39. CFE's Certificate of Incorporation contains a standard "purposes" clause stating that it may engage in any lawful business. Its draft application filed on May 2, 2002 stated that it intended to trade narrow- and broad-based stock index futures. The applicant subsequently advised that initially it intends to trade only broad-based stock index futures.

⁴ The staff working group reviewing CFE submitted the following question to the Exchange on October 29, 2002: "Please explain whether, and if so, how, the [CBOE]'s participation in the [OCX] joint venture could hamper or restrain the [CFE]'s manner of operating or its ability to conceive, develop and bring products to market?" On November 8, CFE responded: "The only restriction that CBOE's participation in the [OCX] joint venture places on

conduct of *the applicant* is, or may tend to be, noncompetitive. While CFE is restrained by its parent's covenant from offering certain products through May 2005, CFE itself has done nothing to affect competition.⁵ If any injury could be deemed to arise from the covenant, CFE would not be the causative agent. For the purposes of Core Principle 18, what matters is the conduct of CFE, not the impact of action by others.

3. Conclusion

Thus, staff does not view the joint venture of the parent company as presenting issues with CFE's compliance with Core Principle 18 or with the Commission's obligations under section 15(b) of the Act.

V. Attachments

- A. Application Letter from CFE to the Commission, dated July 18, 2002
- B. CFE Application Index, dated July 31, 2003
- C. CFE Application Memorandum, dated July 29, 2003
- D. CFE Rulebook, dated July 31, 2003
- E. CFE Policies and Procedures, dated June 6, 2003

The other background materials are available to the Commission upon request

the [CFE] results from the "non-competition" provision in the joint venture agreement among CBOE, the [CME] and the [CBOT]."

⁵ CFE, as a subsidiary of CBOE, could not raise a claim of antitrust injury against its parent. Under antitrust laws, members of a corporate family are treated as a single entity. *Cf. Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133 (9th Cir. 2003). The single-entity rule is stated conventionally as a company cannot conspire with itself. *Copperweld Corp. v. Independence Tube Corp.*, 478 U.S. 752, 769 (1984). The rule normally is raised as a defense against a claim that two or more entities have combined to restrain trade. Our research identifies no cases involving antitrust claims between corporate affiliates.